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No. _____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

995 FIFTH AVENUE ASSOCIATES, L.P.,

Petitioner,

—v.—

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE; JAMES W. WETZLER, As Commissioner of Taxation and Finance; and EDWARD V. REGAN, As Comptroller of the State of New York,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether under Section 1146(c) of the Bankruptcy Code the New York State Gains Tax is a "stamp tax or similar tax" from which a Chapter 11 debtor is exempt.

PARTIES TO THE PROCEEDING

The parties to the proceeding in the court below were 995 Fifth Avenue Associates, L.P., a Delaware limited partnership ("Fifth Avenue Associates"); New York State Department of Taxation and Finance, James W. Wetzler, as Commissioner of Taxation and Finance, and Edward V. Regan, as Comptroller of the State of New York (collectively, "New York").

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

995 Fifth Avenue Associates, L.P., Debtor, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The amended opinion of the United States Court of Appeals for the Second Circuit (1a)[1] is reported at 963 F.2d 503. The initial opinion of the United States Court of Appeals for the Second Circuit (22a) is unreported. The opinion and order of

1 The pages of the Appendix to this petition are referred to as "____a."

the United States District Court for the Southern District of New York (44a) is reported at 127 Bankr. 533. The opinion of the United States Bankruptcy Court for the Southern District of New York (71a) is reported at 116 Bankr. 384; its judgment and order (68a) is unreported.

JURISDICTION

The court of appeals entered its judgment and filed its opinion on April 13, 1992. On May 8, 1992 the court of appeals filed an amended opinion. The court of appeals denied a petition for rehearing by order dated May 29, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant portions of 11 U.S.C. § 1146(c); Ala. Code § 40-22-1 (Michie Supp. 1991); Del. Code § 5402 (Michie 1985 & Supp. 1990); Ill. Ann. Stat. ch.120, § 1003 (West Supp. 1992); Mass. Gen. Law Ann. ch.64D, § 1 (West Supp. 1992); Minn. Stat. Ann. § 287.21 (West 1989); N.Y. Real Prop. Acts. § 1354 (McKinney 1979 & Supp. 1992); N.Y. Tax Law §§ 1402, 1440, 1441, 1447 (McKinney 1987 & Supp. 1992); N.Y.C. Admin. Code § 11-2102 (Lenz & Riecker 1989); Pa. Stat. Ann. tit. 72, § 8102-C (West 1990); Phil. Code § 19-1403 (Pa. Tax Rep 1989 CCH); Vt. Stat. Ann. tit. 32, § 9602 (Equity 1991); and Wash. Rev. Code §§ 82.45.060, 82.46.010, 82.46.035, 82.46.070 (West Supp. 1992) are set forth in the Appendix.

STATEMENT OF THE CASE

Fifth Avenue Associates was the owner and operator of the Stanhope Hotel (46a). On February 4, 1988 Fifth Avenue Associates filed a petition for relief under Chapter 11 of the Bankruptcy Code (*id.*). By order dated November 29, 1988

the bankruptcy court authorized Fifth Avenue Associates to sell its interest in the Stanhope Hotel as an essential element of its Chapter 11 plan (the "Sale") (*id.*).

A tax of ten percent is imposed by N.Y. Tax Law §§ 1440 *et seq.* (the "Gains Tax") upon what the law describes as "gains derived from the transfer of real property within the state" (114a). The New York State Department of Taxation and Finance (the "Tax Department") imposed a $2,608,603.80 Gains Tax assessment on the Sale (46a). The Tax Department denied a request by Fifth Avenue Associates for an exemption from payment of the tax pursuant to § 1146(c) of the Bankruptcy Code (*id.*). Under New York law a conveyance may not be recorded unless a Gains Tax assessment is paid (*id.*). Consequently, Fifth Avenue Associates paid the Gains Tax under protest to allow the $76 million Sale to close on January 13, 1989 (*id.*).

On March 6, 1989 Fifth Avenue Associates commenced this action in the bankruptcy court seeking, *inter alia*, a judgment that the Sale was exempt from Gains Tax liability pursuant to § 1146(c) of the Bankruptcy Code and an order directing that the Gains Tax payment be refunded (4a). The bankruptcy court subsequently granted a motion for summary judgment by Fifth Avenue Associates. It found that New York had waived its sovereign immunity and eleventh amendment rights by asserting an additional $2,137,496.76 Gains Tax claim against Fifth Avenue Associates, notwithstanding the fact that the proof of claim was filed some months after oral argument (*id.*). The bankruptcy court further found that the Gains Tax was a "stamp tax or similar tax," and thus fell within the § 1146(c) exemption (*id.*). It rejected New York's contention that the Gains Tax was a form of income tax, observing that the Gains Tax was imposed on a transaction by transaction basis without allowing a gain to be offset by losses incurred by other sales during the same time period (77a-80a). The district court affirmed the decision of the bankruptcy court, but was reversed in part by the Second Circuit Court of Appeals (20a-21a). The court of

appeals agreed that New York had waived its claim to sovereign immunity or an eleventh amendment defense by the filing of the proof of claim (11a-12a). However, it rejected the lower court's finding that the Gains Tax was a "stamp tax or similar tax" within the meaning of § 1146(c) (19a-20a).

The district court utilized a three-prong test to define a stamp tax. First, it found that the Gains Tax was imposed only at the time of sale without regard for any other transfers (56a). Second, the district court found that payment of the Gains Tax was a prerequisite for recording a conveyance (*id.*). Third, the district court found that the consideration paid played an essential role in calculating the amount of Gains Tax due, thus satisfying the final element of the three-prong test (*id.*).

The Second Circuit found that the district court ignored three relevant differences between the Gains Tax and a "stamp tax or similar tax" (19a-20a). Most important, the court of appeals observed that the Gains Tax was imposed only when the underlying transaction yielded a gain, while a stamp or similar tax was imposed "irrespective of the existence of gain or profit" (19a). Second, the Second Circuit found that while the amount owed under a stamp tax or similar tax "hinge[d] on the consideration for the transferred item," the consideration was used only as a means for calculating gain in imposing the Gains Tax (20a). Third, the Second Circuit found that the ten percent rate imposed by the Gains Tax was far in excess of the low rates of one percent or less which characterize stamp taxes or documentary transfer taxes (*id.*).

Fifth Avenue Associates, with the support of Sanwa Bank, sought a rehearing from the court of appeals. The Second Circuit filed an amended opinion which recharacterized a one percent tax rate as a guide, rather than a maximum rate which might be imposed by a tax which fell within the § 1146(c) exemption. *Compare* (17a) with (38a) (addition of "typically" and footnote 5 in the amended opinion). The court of appeals

then denied the petition for rehearing without further opinion (98a-99a).

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW CONFLICTS WITH THE APPROACH ADOPTED BY THIS COURT AND COURTS ACROSS THE NATION TO THE DETRIMENT OF IMPORTANT NATIONAL INTERESTS

This Court has recognized the importance of utilizing Chapter 11 to maximize the value of a debtor's estate. *Toibb v. Radloff*, 111 S.Ct. 2197, 2201 (1991). Chapter 11 has become of unprecedented importance in this period of massive real estate and corporate failures. Section 1146(c) was enacted for the purpose of "facilitat[ing] reorganizations through giving tax relief." *City of New York v. Jacoby-Bender, Inc.* (*In re Jacoby-Bender, Inc.*), 758 F.2d 840, 841 (2d Cir. 1985). The court below has undermined this purpose by unwarrantably reversing the decisions of the lower courts and excluding the Gains Tax from the § 1146(c) exemption.

Courts across the nation have broadly interpreted the Bankruptcy Code's § 1146(c) exemption of the imposition of a "stamp tax or similar tax" upon a transfer made pursuant to a Chapter 11 plan. A broad interpretation of the exemption is consistent with the language of the provision, which under the Bankruptcy Act had been limited only to an exemption from the payment of a stamp tax, *see* 6A *Collier on Bankruptcy* § 15.08 (14th ed.), as compared to the Bankruptcy Code's more expansive "similar tax" exemption. In the decision below, the Second Circuit without explanation reversed the approach it adopted in its earlier decision in *Jacoby-Bender*, 758 F.2d 840, and instead imposed a narrow interpretation on the § 1146(c) exemption. Such a position is in conflict with the approach taken by courts across the nation. *E.g., In re Cantrup*, 53 Bankr. 104 (Bankr. D. Col. 1985); *CCA Partnership v. Direc-*

tor of Revenue (In re CCA Partnership), 70 Bankr. 696 (Bankr. D. Del.), *aff'd*, 72 Bankr. 765 (D. Del.), *aff'd*, 883 F.2d 303 (3d Cir. 1987); *City of New York v. Smoss Enterprises Corp. (In re Smoss Enterprises Corp.)*, 54 Bankr. 950 (E.D.N.Y. 1985); *In re Permar Provisions, Inc.*, 79 Bankr. 530 (Bankr. E.D.N.Y. 1987); *City of New York v. Baldwin League of Independent Schools (In re Baldwin League of Independent Schools)*, 110 Bankr. 125 (S.D.N.Y. 1990). Moreover, in rendering its decision the Second Circuit simply ignored basic rules of statutory construction in interpreting the language of § 1146(c).

In interpreting a statute this Court repeatedly has stated that the starting point should be the language of the statutory provision. *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). Legislative history is only a secondary guide to be utilized when the language in a statute is ambiguous. *Id.*; *Radloff*, 111 S.Ct. at 2200. In the decision below, the Second Circuit turned this basic canon of statutory interpretation on its head. Having found no legislative history which would illuminate the meaning of the text, the court of appeals simply terminated its consideration of the meaning of the term "similar tax."

When asked to interpret a Bankruptcy Code exemption this Court will give a "natural reading" to the "plain language" of the provision. *Patterson v. Shumate*, 112 S.Ct. 2242, 2246 (1992). When everyday English is used, this Court will assume Congress intended to give a word its "ordinary meaning," the meaning ascribed to it in "ordinary parlance" and in "dictionary definitions." *United Air Lines, Inc. v. McMann*, 434 U.S. 192, 203 (1977). In everyday English "similar" is understood to mean "having a likeness or resemblance, esp. in a general way. . . ." *The Random House Dictionary of the English Language* 1782 (2d ed. unabrgd 1987). Had the Second Circuit attempted to apply such a definition in its analysis of § 1146(c), the Gains Tax would have been found to fall within the exemption's purview.

The meaning of the term similar frequently has arisen in interpreting the United States tariff laws. In *Greenleaf v. Goodrich*, 101 U.S. 278 (1879) this Court was asked to determine the meaning of the term "goods of similar description." It recognized that differences existed between the goods being subjected to scrutiny and the type of goods specifically cited in the tariff law in question. *Id.* at 281. However, this Court did not find that the existence of some differences, by themselves, was sufficient. It wrote:

> The words "of similar description" in the delaine clause of the act of 1862 cannot be affirmed to have referred only to such goods as have the greater number of characteristics in common with delaines. Some common characteristics are of much more importance than others in determining resemblances.

Id. at 282. This need to evaluate the differences in goods to determine whether they are of a similar nature has continued to be a basic element in interpreting the tariff laws. *See, e.g., E. Dillingham, Inc. v. United States*, 328 F.Supp. 1392, 1400-02 (Cust. Ct. 1971). The need to weigh differences has also been found to be necessary in determining whether goods are similar in connection with tax exemptions. *See City of Phoenix v. Marathon Steel Co.*, 722 P.2d 341, 344-45 (Ariz. App. 1985) (differences outweigh similar features, causing steel company to be exempt from local license fee).

In considering the applicability of a tax exemption this Court will not treat two taxes differently, unless they differ in a "significant way." *United States v. New Mexico*, 455 U.S. 720, 738 (1982). Where the application of a tax exemption is contingent upon whether a tax is similar in nature to another tax, the tax under scrutiny must be "systematically analyzed" and its operation assessed by some "cogent theory of what makes a tax 'similar'. . . ." *Colorado Interstate Gas Co. v. Federal Energy Regulatory Comm'n*, 850 F.2d 769, 773 (D.C. Cir. 1988). Without such a systematic evaluation there would be an elevation of

form over substance. *See Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 444 (1827) (license fee imposed upon sellers of imported goods cannot escape constitutional prohibition against imposition of duties on imports by individual states based upon claim that tax is upon seller's occupation rather than upon imported goods).

If the court below had undertaken a systematic analysis of the meaning of the term "similar tax" rather than relying upon a faulty, incomplete survey, it would have found that the district court was correct in defining the Gains Tax as a "stamp tax or similar tax." The distinguishing characteristics which the Second Circuit identified as taking the Gains Tax outside of the § 1146(c) exemption either do not exist or are of too minor importance to cause the Gains Tax to be dissimilar to a stamp tax.

In its amended opinion the court below found that the Gains Tax was not similar to a stamp tax because of the ten percent rate at which the Gains Tax is imposed as compared to the usual one percent or less rate imposed by taxes within the § 1146(c) exemption (20a). The Second Circuit ignored the existence of stamp taxes with a rate in excess of one percent throughout the country. Contrary to statements made in the opinion, the Vermont property transfer tax is imposed at a rate of 1.25%. (*See* 16a, 123a).[2] The realty transfer tax in Delaware is imposed at a rate of 2% of the value of the property (102a). Philadelphia imposes a real property transfer tax of 3.46% (121a-22a). The state of Pennsylvania imposes an additional tax of 1% (120a), which increases the total tax burden on real estate transfers to 4.46%. In the state of Washington, the combined local and state real property transfer tax rate may be as high as 3.28% (124a-27a). Numerous real property transfer and

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2 The ½% rate cited in the decision below is applied only to the first $100,000.00 in value of sales of principal residences and other limited exceptions to the 1.25% rate. (*id.*) This mischaracterization of the Vermont tax rate in the opinion below is reflective of the faulty analysis upon which the Second Circuit's decision is based.

recording taxes in the New York metropolitan area have a rate in excess of one percent, including the New York City Real Property Transfer Tax (the "RPT"), which is imposed at a rate of 2.625% when gross consideration exceeds $500,000.00 (118a-19a).

In its amended opinion the Second Circuit attempted to minimize the extent of its faulty analysis by recharacterizing a rate of one percent or less as typical, rather than as an absolute maximum for a tax which fell within the § 1146(c) exemption. However, the more basic failure in the Second Circuit's analysis remained unaddressed. A high tax rate is significant because of the greater burden a high rate imposes. Because the Gains Tax is imposed upon only a portion of the consideration, it is misleading to focus only upon the difference in the rates between the Gains Tax and other taxes which are recognized as falling within the § 1146(c) exemption. For example, rather than there being a great disparity between the Gains Tax and the RPT, an examination of how these taxes operate reveals that they are taxes of comparable magnitude.

Using a $76,000,000.00 sale price, the price paid for the Stanhope Hotel, a tax of $1,995,000.00 would be imposed by the RPT. When combined with an additional $304,000.00 which would be exacted by the New York State Real Estate Transfer Tax (the "RETT") (*see* 109a), a total of $2,299,000.00 in these taxes would be imposed on a $76,000,000.00 sale, only twelve percent less than the $2,608,603.80 Gains Tax recovery being sought by Fifth Avenue Associates. Moreover, if the sale price in the above example is reduced to a hypothetical, but still very respectable $60,000,000.00, the Gains Tax would be approximately $1,000,000.00, less than two-thirds the amount of the $1,575,000.00 which would be exacted by the RPT alone. Thus, the difference in tax rates cited by the Second Circuit is not the kind of difference which would cause the Gains Tax to be dissimilar to a stamp tax, because the difference in rates does not result in a corresponding difference in magnitude.

The decision below also rests on the premise that a "stamp tax or similar tax" is determined solely by using "either the par value of the security, the consideration in the deed, or the value of the property that is the subject of the transaction" (17a). The decision contrasts such a measure of taxation with the Gains Tax calculation in which the court below stated that "the consideration is used only as a means to measure the gain accruing to the transferor as a result of the transfer" (20a). Again, the Second Circuit has overlooked examples of stamp or similar taxes which are not calculated by using par value and which only utilize a portion of the consideration or the value of the transferred item in deriving the amount of the tax.

For example, the decision below cites the New York State RETT as a tax which falls within the § 1146(c) exemption (16a). However, when the RETT is applied to the transfer of a single family home, or when the consideration is less than $500,000.00, the value of any continuing lien will be excluded (109a). Thus, if an individual purchases a house for $600,000.00, pays $200,000.00 in cash and the remainder by assuming an outstanding mortgage of $400,000.00, the RETT will be calculated by using only $200,000.00 as the base. This amount is neither the consideration, the value of the property being transferred, nor par value, the alternative values upon which the court below stated a tax must be imposed in order to fall within the § 1146(c) exemption.

The practice of deducting the amount of outstanding mortgages is not limited to New York. In Alabama, Illinois, Massachusetts and Minnesota the amount of an assumed mortgage is also deducted in calculating those states' real property transfer taxes, in both residential and commercial transactions.[3]

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3 The decision as to whether to allow the value of outstanding mortgages to be deducted from the taxable base can have a major impact on the magnitude of a tax. For example, in a commercial transaction where a purchaser was seeking a 10% return on an investment, he would be willing to pay $11,700,000.00 ($7,000,000.00 in cash and $4,700,000.00 by assuming an existing mortgage) for a building which produced

See 101a, 104a-106a. Thus, the decision below again distinguishes the Gains Tax from a stamp tax by isolating a difference which would confuse the application of the § 1146(c) exemption in other parts of the country. If these other taxes fall within the § 1146(c) exemption, why should the Gains Tax be excluded?

Ultimately, the only alleged difference identified by the Second Circuit which has any real significance is the claim that liability for the Gains Tax is "always contingent on the profitability of the underlying transaction" (19a). As measuring profit under the Gains Tax formula does not allow for an offsetting of losses from other transactions during the same tax period (77a), this difference alone should not be sufficient to place the Gains Tax outside of the § 1146(c) exemption. However, consideration of this question is unnecessary, as the Gains Tax, contrary to the unsubstantiated position taken by the Second Circuit, is imposed even when a seller suffers a loss.

Last year the manner in which profits are calculated under the Gains Tax law received detailed scrutiny in the joint report of the New York State Bar Association Tax Section and The Association of the Bar of the City of New York Committee on State and Local Taxation, *Application of the New York State 10% Tax on Gains Derived from Certain Real Property Transfers to Transfers Involving Interests in Troubled Real Estate* (1991) (hereinafter described as *Bar Assoc. Rep.*). This report identified major costs which are disallowed in calculating gain including interest on land acquisition loans during construction, pre-construction zoning approval costs and the post-construction costs of carrying unsold and unleased space. *Id.* at

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$700,000.00 per year in net income after taxes and debt service. If the transaction occurred in a state with a one percent tax rate which allowed the amount of an existing mortgage to be deducted, the tax would be $70,000.00 based upon a $7,000,000.00 cash base. If a state required the amount of an outstanding mortgage to be included in the stamp tax calculation, the tax would be $117,000.00, a 67% greater amount, as the one percent rate would be applied to the full $11,700,000.00 of consideration.

14-26. The bar association committees concluded that the Gains Tax "is imposed on phantom gains, and sometimes is imposed even where there is an economic loss on the project." *Id.* at 4. If the Gains Tax is imposed on transactions in which losses are incurred, the Second Circuit's reliance upon a belief that the Gains Tax is imposed only on profitable transactions is clearly without merit.

The facts in this case reflect the extent to which the Gains Tax is imposed on transfers in which there is an economic loss incurred. Creditor claims are at least $14,000,000.00 greater than the assets of Fifth Avenue Associates. If the exemption of the Gains Tax under § 1146(c) is reinstated, the likely primary beneficiary in this case will be the Resolution Trust Corporation, which holds a non-administrative expense claim of approximately $10,000,000.00. The Federal Deposit Insurance Corporation also has interest in the outcome of this appeal, given its large holdings of troubled mortgages on New York properties.

If the Second Circuit's analysis of the Gains Tax is allowed to stand, it will serve as an invitation for state and local governments to bring unwarranted challenges to a Chapter 11 debtor's rightful use of the § 1146(c) exemption. Earlier cases involving § 1146(c) reflect the unsubstantial distinctions which are likely to be asserted. For example, in *Cantrup*, the City of Aspen argued that its real estate transfer tax was not exempt under § 1146(c) because it was the purchaser, not the Chapter 11 debtor, "who accepted the deed and present[ed] it for recording." 53 Bankr. at 105. The *Cantrup* Court rejected this argument by noting that, "while the City's argument has initially a certain ingenius [sic], abstruse and abstract intellectual appeal, it fails to make a practical distinction." *Id.* at 106. Obviously, there is no meaningful difference between the delivery and recording of a deed in this context. Once a state establishes a system for recording conveyances, a purchaser of real property must record a transfer to protect its rights of ownership. *Baldwin League of Independent Schools*, 110 Bankr. at

127. By failing to evaluate the significance of the tax characteristics upon which its opinion relies, the Second Circuit has created precedent for comparable specious future challenges to the application of the § 1146(c) exemption. As described earlier, numerous real estate transfer taxes fail to conform to the narrow criteria for a "stamp tax or similar tax" established by the Second Circuit. Unwarranted challenges which will delay reorganizations and deplete the limited resources of Chapter 11 debtors will be encouraged, unless this Court establishes an appropriate guide for applying the § 1146(c) exemption.

New York City has the greatest concentration of office buildings in this country. More than thirty percent of this nation's downtown commercial office space is located in the New York City metropolitan area. U.S. Dept of Commerce, *Statistical Abstract of the United States 1991* at 733. Thus, many individuals and institutions throughout this country who have made loans or invested in New York real estate will be affected by the outcome of this case. In this period of mounting real estate failures the § 1146(c) exemption is of growing importance. The differences in tax characteristics relied upon by the Second Circuit cannot withstand scrutiny. Given the significance of the § 1146(c) exemption to local and national interests, and even international lenders (see section II, *infra*), this Court should not allow the mistaken analysis of the Second Circuit Court of Appeals to go unreviewed. Its decision should not be allowed to frustrate Congress's intention to facilitate Chapter 11 reorganizations by providing tax relief.

II. THE DECISION BELOW ALLOWS FOR THE CONTINUED DISCRIMINATORY IMPOSITION OF THE GAINS TAX IN VIOLATION OF THE DOCTRINE OF INTERGOVERNMENTAL TAX IMMUNITY

The imposition of the Gains Tax on transfers which produce no gain resulted in a 1984 revision of the New York foreclosure law which subordinated the payment of the Gains Tax to the satisfaction of existing mortgages when a property is trans-

ferred in a foreclosure sale. Bar Assoc. Rep. at 1-2, 31-32. Now, before the Gains Tax is paid, the proceeds of a sale are used to satisfy existing mortgages on the property. Only if excess monies remain are sale proceeds used to satisfy the Gains Tax (107a-108a). In addition, the Gains Tax law was amended by the addition of § 1447.3(b) to eliminate the secondary liability of a transferee to pay the Gains Tax, if the property is transferred in an action to foreclose a mortgage (116a).

No such adjustments are made if a property is sold in bankruptcy. In bankruptcy even when the sale proceeds are insufficient to satisfy existing mortgages, the deed will not be recorded unless the Gains Tax is paid. Moreover, transferee liability continues. This less favorable tax treatment of troubled properties in bankruptcy represents a disparate imposition of the Gains Tax which violates the constitutional protections afforded by the doctrine of intergovernmental tax immunity.

The doctrine of intergovernmental tax immunity was first established in *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819). The doctrine is directed at preventing state and local tax authorities from imposing burdens which interfere with the activities of the federal government and the exercise of congressional power. *Davis v. Michigan Dept of Treasury*, 489 U.S. 803, 810 (1989); *City of Detroit v. Murray Corp. of America*, 355 U.S. 489, 496-97 (1958).

Over the last fifty years the scope of the intergovernmental tax immunity doctrine has been reduced. *Davis*, 489 U.S. at 811. The imposition of a non-discriminatory economic burden upon a federally sponsored activity is no longer barred. *United States v. County of Fresno*, 429 U.S. 452, 462 (1977). However, taxes remain constitutionally invalid if they are discriminatory in nature. *E.g.*, *Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 376 (1960); *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744 (1961). Even significant differences between the entities being taxed will not justify disparate tax treatment unless the differences can be shown to

be directly related to the inconsistent tax treatment. *Davis*, 489 U.S. at 816; *Barker v. Kansas*, 112 S.Ct. 1619, 1623 (1992). Included within this constitutional prohibition against disparate tax treatment are discriminatory state taxes which place additional burdens upon the sale of property in bankruptcy. *California State Board of Equalization v. Sierra Summit, Inc.*, 490 U.S. 844, 850 n.6. (1989).

The inequitable and discriminatory effect of the disparate imposition of the Gains Tax in state foreclosure and bankruptcy sales was described in Sanwa Bank's *amicus curiae* brief in support of Fifth Avenue Associates' petition for a rehearing to the Second Circuit:

> In the current environment, if this Court's [Second Circuit's] decision is given effect, it will be the mortgage lender, not the borrower, that will pay the New York Transfer Gains Tax in Chapter 11 restructurings. . . . The following example will illustrate a typical scenario faced by commercial real estate lenders in New York.
>
> A developer has borrowed $200 million from a bank pursuant to a nonrecourse mortgage loan to fund the construction of a building. After completing construction of the building, the developer's "original purchase price" for New York Transfer Gains Tax purposes is only $150 million because, in part, the New York Transfer Gains Tax rules arbitrarily exclude certain capital expenditures from the calculation of original purchase price. Due to current conditions in the New York real estate market, the building has a current fair market value of $100 million. The developer is in default on his mortgage, the lender commences a foreclosure action and the developer responds by filing for protection under Chapter 11 of the Bankruptcy Code.
>
> Assuming under either the foreclosure or Chapter 11 scenario the building will be transferred to the bank in satisfaction of its claim, the face amount of the mortgage

> ($200 million) will be treated as the consideration for purposes of computing the New York Transfer Gains Tax. The developer will be treated as having a $50 million taxable gain, and the New York Transfer Gains Tax will be $5 million. If the developer has insufficient cash to pay the tax, which is likely to be the case, the bank in the Chapter 11 case, but not the foreclosure scenario, will be required to pay the tax before it can record its deed. Thus, the bank, which already has suffered substantial economic loss, will be out-of-pocket the additional amount of the New York Transfer Gains Tax.
>
> * * *
>
> The Court's decision may well lead lenders to pursue contested foreclosures rather than to participate in consensual Chapter 11 proceedings . . . resulting in a series of contested motions to the detriment of the reorganization process and at great expense to the estate. . . . A further effect of pursuing foreclosure rather than Chapter 11 will be that mechanics' lienors and unsecured creditors will receive nothing in satisfaction of their claims. In contrast, those creditors frequently receive some distributions from estates in Chapter 11.

Brief of the Sanwa Bank Limited, New York Branch, As *Amicus Curiae*, In Support of Petition for Reargument and Suggestion for Rehearing In Banc at 5-8 (2d Cir. 1992) (No. 91-5038) (citations omitted).

The Second Circuit refused to consider the disparate burden created by the Gains Tax if the problems of troubled properties are addressed in bankruptcy rather than through foreclosure. This disparate treatment unfairly penalizes property owners and creditors who want to avail themselves of the bankruptcy process rather than utilizing state foreclosure remedies. The imposition of additional losses on financially weakened lenders has the further effect of reducing the availability of new loans in an

environment already suffering from a shortage of capital.[4] Such inequitable and discriminatory burdens are barred by the doctrine of intergovernmental tax immunity.

If the decision below is allowed to stand the constitutionality of the Gains Tax will be placed in jeopardy. This Court repeatedly has stated that, where possible, a statute should be interpreted so as to avoid a constitutional infirmity. For example, in *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg & Constr. Trades Council*, 485 U.S. 568 (1988), this Court stated:

> [W]here an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress.

Id. at 575. This same rule is applicable where constitutional problems arise in interpreting state statutes. *See, e.g., Hooper v. California*, 155 U.S. 648, 657 (1895). By addressing the faulty construction of the § 1146(c) exemption by the Second Circuit Court of Appeals, this Court may avoid problems "of the greatest difficulty and delicacy," which arise in the interpretation of intergovernmental tax immunity questions. *United States v. City of Detroit*, 355 U.S. 466, 474 (1958). Given the economic importance and legal significance of the question presented, this Court's direction is needed in settling this controversy.

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4 James W. Wetzler, one of the respondents in this case, has stated: " 'Long after the recession is over, the way this tax [Gains Tax] has worked in workout situations may make banks less willing to lend on New York real estate.' " *Crain's New York Business*, July 8, 1991 at 3.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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